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FISCAL IMPACT STATEMENT

LS 7454 | **NOTE PREPARED:** Jan 24, 2015
BILL NUMBER: SB 492 | **BILL AMENDED:**

SUBJECT: Various Pension Matters.

FIRST AUTHOR: Sen. Boots | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** | **IMPACT:** State & Local
X **DEDICATED**
X **FEDERAL**

Summary of Legislation: The bill provides that an individual who is a first-time full-time employee of the state or a participating political subdivision after June 30, 2015, becomes a member of the Public Employees' Defined Contribution Plan (ASA Only Plan) unless the individual makes an explicit election to become a member of the Public Employees' Retirement Fund (PERF). (This reverses the presumption under current law.)

The bill provides that a political subdivision may participate in the Public Employees' Defined Contribution Plan (ASA Only Plan).

The bill provides that an employer that is eligible but not required to participate in PERF must pay the employer's share of the unfunded liability attributable to the employer's current and former employees if the employer withdraws from PERF or otherwise reduces the employer's participation in PERF by attrition.

The bill also provides that after December 31, 2015, members and beneficiaries of any public pension fund administered by the Indiana Public Retirement System (INPRS) may receive monthly benefits only by direct deposit or another method approved by the board of trustees of INPRS.

The bill provides that an entity that is eligible but not required to participate in PERF and that wishes to offer a retirement plan to an employee must participate in either PERF or the Public Employees' Defined Contribution Plan (ASA Only Plan).

The bill requires the Office of Management and Budget (OMB) to report to the Interim Study Committee on Pension Management Oversight each year concerning information received from political subdivisions about

the subdivisions' retirement plans.

The bill expires a section concerning methods of paying monthly benefits to members and beneficiaries of PERF and the Teachers' Retirement Fund (TRF).

Effective Date: Upon passage; July 1, 2015.

Explanation of State Expenditures: *Withdrawal/Freezing from PERF:* The bill affects the state as an employer. Currently, the state will realize an increase in its employer contribution rate over time due to the decisions of some other discretionary entities. The bill will eliminate this increase in the state's contribution rate.

State Educational Institutions & Separate Bodies Corporate and Politic: The bill affects state educational institutions, as well as separate bodies corporate and politic, in as much as they may be withdrawing participating entities and may choose to withdraw from PERF (either in whole or in part) or may prohibit new employees from enrolling in PERF. In those cases where they do withdraw employees or restrict enrollment into PERF for new employees, they are liable for the future benefits payable for their current and former employees who are enrolled in PERF.

Directly impacted by the bill are four state educational institutions that are known to have "frozen" new employees from participation in PERF since December 31, 2010. These institutions include Ivy Tech, Indiana University, Purdue University, and the University of Southern Indiana. The net present value of the total liabilities owed by these institutions is $73 M.

Any withdrawing participating entity who withdraws or freezes from PERF and chooses to continue to offer a retirement plan for employees must participate in either the ASA Only Plan or another defined contribution plan.

Additional ASA Contributions from Employers: The bill allows that employers may opt to make additional contributions to employee ASA accounts. Specifically, employers may opt to contribute an additional 1% of a member's compensation for every 2% of additional compensation that a member voluntarily contributes to their ASA. Members are then able to contribute an additional amount (either pretax or posttax) to the ASA. Currently, member contributions are limited to 10% of their salary per pay period. The cost to employers from this provision depends on decisions made by the individual employers.

Office of Management and Budget (OMB): Currently, local units must report on their various retirement plans annually through the Gateway for Government Units. The State Board of Accounts must report on this submitted data annually to the Interim Study Committee on Pension Management Oversight. The bill requires that OMB shall compile a written report for the Committee that summarizes and analyzes the retirement plan information received each year. The bill's requirements are within the agency's routine administrative functions and should be able to be implemented with no additional appropriations, assuming near customary agency staffing and resource levels.

As of November 2014, 418 local units of government reported 418 retirement plans. These plans do not include plans administered by INPRS. These plans consist of defined benefit, defined contribution, and hybrid retirement plans. Approximately 39% of these plans are defined benefit plans.

ASA Plan for New Employees: The bill requires that new state employees will be automatically enrolled in the ASA Only Plan instead of PERF, unless the employee elects to do otherwise. Currently, the opposite is true, and new employees default to PERF membership. LSA estimates that roughly 3,000 new state employees will be eligible for enrollment in the ASA Only Plan each year.

The bill is expected to greatly increase the number of new state employees that become members of the ASA Only Plan. This will not immediately have an impact on state employer contribution rates (which are 11.2% in FY 2015). Employees will contribute 3% of their salary (which is picked up by the state for state employees), and state contributions are the same for the ASA Only Plan as for PERF. Specifically, the employee's account receives a minimum of 3% and not greater than the actuarial normal cost of the Hybrid Plan, currently 4.6%. The amount not credited to the member's account is applied to PERF's unfunded liability (11.2% less 4.6%, which equals a 6.6% contribution to PERF's unfunded liability).

However, it is likely that over the long term, the shift of new employees to the ASA Only Plan will decrease costs for the state, as the unfunded liability of PERF decreases. Also, in times of a bad economy, to the extent that more PERF assets are part of the ASA Only Plan, losses to the state will be minimized. In the case of PERF, the unfunded liability will increase in an economic downturn as the value of assets decrease, thereby increasing state costs.

INPRS: The bill requires that INPRS calculate additional amounts owed by withdrawing participating entities. This requirement is within the agency's routine administrative functions and should be able to be implemented with no additional appropriations, assuming near customary agency staffing and resource levels.

The bill eliminates the use of paper checks to INPRS' beneficiaries. The vast majority of pension plan members and beneficiaries receive their monthly benefits through direct deposit. Currently, a member or beneficiary must submit a waiver to INPRS in order to receive a paper check. INPRS spent $212,400 issuing 180,000 paper checks to members and beneficiaries in FY 2014. The bill will allow the INPRS board, at their discretion, to provide electronic benefit transfer (EBT) cards in lieu of paper checks, thereby eliminating this expense.

The bill will require that INPRS deal with a potential increase of new local employers. Also, INPRS will, over time, shift resources from PERF to the ASA Only Plan, as more and more active members age out of PERF. The bill's requirements may represent an additional workload for INPRS outside of the agency's routine administrative functions. Therefore, existing staffing and resource levels, if currently being used to capacity, may be insufficient for full implementation.

<u>*Additional Information*</u>: *Withdrawal/Freezing from PERF*: Several local entities as well as state educational institutions have prohibited new employees from becoming members of PERF since 2011. These decisions were allowed according to existing PERF statute, and these entities were able to do this, in some cases, without providing notice to INPRS.

Not allowing new employees to become members of PERF, or "freezing", is different from a withdrawal, where notice to INPRS is required. It is possible, due to the lack of a notice requirement for freezing, that there are additional entities that have done this and are planning to act in a similar manner to these entities that have already placed "freezes" on PERF enrollment.

PERF is a cost-sharing pension plan where all employers pay the same contribution rate (currently 11.2% for all but a handful of local employers). Consequently, when these entities froze enrollment into PERF, they shifted some of the liabilities for their current and former employees in PERF to the other PERF employers. This is due to the fact that the affected discretionary entities are paying a contribution rate based on a gradually shrinking affected payroll (since the contribution rate is only paid on the portion of the employer's payroll that is covered in PERF).

According to INPRS, the decisions by these entities will cost other PERF employers approximately $97 M in additional liabilities in today's dollars.

It is expected that these additional liabilities will be slowly absorbed by the remaining employers through 2043 and will, over time, increase their contribution rate by 0.23%. By 2043, the $97 M liability shift will ultimately cost the remaining employers $256 M.

Move to ASA Only Plan: PERF members typically participate in a hybrid pension system, consisting of both a conventional pension benefit and an annuity savings account (ASA) which is funded by member contributions. State employees who are members of PERF have their 3% member contribution into the ASA "picked up" by the state, which means that the state, as the employer, makes the contribution on the member's behalf. Members are then able to contribute an additional amount (either pretax or posttax) to the ASA. Currently, member contributions are limited to 10% of their salary per pay period.

The ASA Only Plan, which began operating in March 2013, is available to new state employees who were not previously members of PERF. Employer contributions are identical for both the ASA Only Plan and PERF.

In the ASA Only Plan, the employee's account receives a minimum of 3% and a variable rate contribution that is not greater than the actuarial normal cost of PERF, currently 4.6%. The amount not credited to the member's account is applied to the Hybrid Plan's unfunded liability (11.2% less 4.6%, which equals a 6.6% contribution to PERF's unfunded liability).

Some new employees may choose the ASA Only Plan due to the fact that members in the ASA Only Plan are 100% vested in the ASA Only Plan after 5 years, whereas PERF members are vested after 10 years. The vesting on the ASA Only Plan only refers to the variable rate contribution - the 3% employer contribution and any additional employee contributions are immediately 100% vested.

Explanation of State Revenues:

Explanation of Local Expenditures: *Withdrawal/Freezing from PERF*: Withdrawing participating entities that choose to restrict future enrollment in PERF will be required to pay an amount determined by INPRS in order to cover the entire amount of liabilities of their current and former employees that remain in PERF. Local entities that are known to have already prohibited new employees from becoming members of PERF have known liabilities with a net present value of approximately $24 M.

Any withdrawing participating entity who withdraws or freezes from PERF and chooses to continue to offer a retirement plan for employees must participate in either the ASA Only Plan or another defined contribution plan.

Mandatory Participation in PERF: Approximately 1,200 local units participate as employers in PERF currently. The bill requires that local units who previously did not offer retirement plans to their employees but choose to do so after July 1, 2015, must participate in either PERF or the ASA Only Plan. There are roughly over 3,800 units that may possibly be affected by the bill. If all of these units opt to provide retirement benefits (and therefore become part of PERF or the ASA Only Plan), the number of local employers in PERF or the ASA Only Plan could greatly increase.

Local units that have pre-existing pension plans (outside of PERF and the ASA Only Plan) and wish to continue providing pension benefits will be able to continue to use pre-existing pension plans for both current and future employees.

Participation in ASA Only Plan: Local employers may choose to opt into the ASA Only Plan for their new employees. If they do choose to participate in the ASA Only Plan, new employees will automatically be enrolled in the ASA Only Plan (new employees may elect to become members of PERF). Currently, the ASA Only Plan is only available to new state employees.

This should not immediately affect the employer contribution rates for local employers, as employer contributions are the same for the ASA Only Plan and PERF. Current employer contribution rates for local PERF employers average11.2% for all but a handful of employers. Note that INPRS hopes to have all local employers, as well as the state, paying the same employer contribution rate within the next several years. It is unknown how many local PERF employers will use the ASA Only Plan-only option.

Explanation of Local Revenues:

State Agencies Affected: INPRS; OMB; State educational institutions; State separate bodies corporate and politic; All.

Local Agencies Affected: All.

Information Sources: 2014 INPRS Update to the Indiana State Budget Committee, November 20, 2014; INPRS presentation to the Pension Management Oversight Committee, September 16, 2014 (https://iga.in.gov/documents/585f90b9); Kathryn Hoffman, INPRS, khoffman1@inprs.in.gov; Tony Green, INPRS, agreen@inprs.in.gov; Indiana Gateway for Government Units local pension data, https://gateway.ifionline.org/ (Accessed 11/25/14).

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